

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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	:	PLAINTIFF FHFA'S
	:	SUPPLEMENTAL
FEDERAL HOUSING FINANCE AGENCY, etc.,	:	SUBMISSION IN SUPPORT
	:	OF ITS PROPOSED
Plaintiff,	:	SAMPLING PROTOCOL
v.	:	
UBS AMERICAS, INC., et al.,	:	11 Civ. 5201 (DLC)
Defendants.	:	
	:	
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FEDERAL HOUSING FINANCE AGENCY, etc.,	:	
	:	
Plaintiff,	:	
v.	:	11 Civ. 6188 (DLC)
JPMORGAN CHASE & CO., et al.,	:	
Defendants.	:	
	:	
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FEDERAL HOUSING FINANCE AGENCY, etc.,	:	
	:	
Plaintiff,	:	
v.	:	11 Civ. 6189 (DLC)
HSBC NORTH AMERICA HOLDINGS, INC., et	:	
al.,	:	
Defendants.	:	
	:	
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FEDERAL HOUSING FINANCE AGENCY, etc.,	:	
	:	
Plaintiff,	:	
v.	:	11 Civ. 6190 (DLC)
BARCLAYS BANK PLC, et al.,	:	
Defendants.	:	
	:	
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FEDERAL HOUSING FINANCE AGENCY, etc.,
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Plaintiff,
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v. 11 Civ. 6192 (DLC)
:
DEUTSCHE BANK AG, et al.,
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:
Defendants.
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FEDERAL HOUSING FINANCE AGENCY, etc.,
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Plaintiff,
:
v. 11 Civ. 6193 (DLC)
:
FIRST HORIZON NATIONAL CORP., et al.,
:
:
Defendants.
:

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FEDERAL HOUSING FINANCE AGENCY, etc.,
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Plaintiff,
:
v. 11 Civ. 6195 (DLC)
:
BANK OF AMERICA CORP., et al.,
:
:
Defendants.
:

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
CITIGROUP INC., et al.,
Defendants.

11 Civ. 6196 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
GOLDMAN, SACHS & CO., et al.,
Defendants.
----- X

11 Civ. 6198 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
CREDIT SUISSE HOLDINGS (USA), INC., et al.,
Defendants.
----- X

11 Civ. 6200 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
NOMURA HOLDING AMERICA, INC., et al.,
Defendants.
----- X

11 Civ. 6201 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
MERRILL LYNCH & CO., INC., et al.,
Defendants.
----- X

11 Civ. 6202 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
SG AMERICAS, INC., et al.,
Defendants.
----- X

11 Civ. 6203 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
MORGAN STANLEY, et al.,
Defendants.
----- X

11 Civ. 6739 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
ALLY FINANCIAL INC., et al.,
Defendants.
----- X

11 Civ. 7010 (DLC)

----- X
FEDERAL HOUSING FINANCE AGENCY, etc.,
Plaintiff,
v.
GENERAL ELECTRIC COMPANY, et al.,
Defendants.
----- X

11 Civ. 7048 (DLC)

**PLAINTIFF FHFA'S SUPPLEMENTAL SUBMISSION IN SUPPORT OF ITS
PROPOSED SAMPLING PROTOCOL**

Pursuant to this Court's Order dated May 15, 2012, in the above-captioned cases (the "Cases"), Plaintiff Federal Housing Finance Agency ("FHFA" or "Plaintiff"), as Conservator for the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together, the "GSEs"), respectfully submits this supplemental submission in further support of its proposed sampling protocol.

BACKGROUND

A. Procedural History

As directed by the Court in its Order dated February 6, 2012, Plaintiff submitted to this Court a proposed sampling protocol, on February 29, 2012, setting forth the steps to design and implement a sampling methodology for the purposes of discovery and trial in the Cases. In its February 29 submission, Plaintiff identified certain information in the possession of Defendants that would enable it to design an appropriate sample for each case – namely, the final loan tapes identifying the loans contained in each Securitization and certain of their credit characteristics, and loan-level information identifying the originator of each loan in the Securitizations at issue in each Case. Plaintiff estimated that once it received this information, it would be able to provide the first case-specific protocol within five weeks. On March 14, 2012, Defendants submitted a response to FHFA's February 29 proposed protocol. Defendants' submission was primarily devoted to arguing that designing a protocol was "wholly premature" before discovery had even begun.

At the status conference held on May 14, 2012, this Court noted that "we're going to sample the loan files from the beginning of the case," that Defendants' March 14 submission was not a meaningful sampling proposal, and that if Defendants refused to meaningfully engage in

the process of selecting a sampling protocol, “so be it.” (Tr. 37:24-25; 52:1-8.) The Court pointed out, however, that “it takes two to tango here” and it “would be thrilled” if Defendants wanted to participate. (Tr. 52:13-14.) The Court’s May 15, 2012 Order directed the parties to submit their sampling protocol proposals by June 6, 2012. In addition, the Court ordered that (i) Defendants provide the final closing loan tapes and information sufficient to identify originators on a rolling basis, with final production to be made by June 8, 2012; and (ii) any party that had such tapes or originator information in its possession, should produce such information by May 18, 2012.

B. Status of Data Received From Defendants To Date

Defendants began producing loan tapes and loan-level originator information on May 18, 2012, and have continued to produce such data on a rolling basis. As of June 5, 2012, Plaintiff has received a substantial majority of the loan tapes and originator information for the 449 Securitizations at issue in the Actions. Defendants have not produced data dictionaries in the majority of cases but in some cases have represented either that no data dictionaries exist or that they have been unable to locate them to date. Plaintiff expects Defendants to continue making additional productions up until the June 8 deadline.¹

However, the data contained on some of the loan tapes produced by Defendants is incomplete or inconsistent with the information contained in the Prospectus Supplements. For example, some loan tapes are missing data fields that may be relevant to the creation of a sample design, such as FICO scores, CLTV/LTV ratios, and identification of the applicable loan group. Other loan tapes contain information such as the number of loans in the securitization that is inconsistent with the number specified in the prospectus supplement for that securitization.

¹ FHFA’s Rule 26(f) Report dated June 6, 2012 sets forth the status of the Defendants’ productions.

Although Plaintiff is working with Defendants to address such deficiencies and inconsistencies in the data, such issues may impact the determination of all aspects of final sample design.

In the interests of assisting the Court in formulating an appropriate sampling design, Plaintiff has utilized the data provided to date to further develop fundamental components of the sample design. There may be modifications to the design based on additional information produced by Defendants, the receipt of missing data, and the reconciliation of inconsistent data.

C. Plaintiff's Efforts To Further Refine Its Sampling Protocol

Pursuant to this Court's suggestion at the May 14 conference (Tr. 49:10-14), FHFA selected the *UBS* Action to provide the first sample design, as it is the first case scheduled for trial. FHFA's sample design in the *UBS* Action is based on its examination of the loan tapes and loan-level originator information provided by the UBS Defendants as of June 4, 2012.

FHFA will continue to utilize the loan tapes and loan-level originator information that is being produced by Defendants in the other Cases to further refine and supplement its initial sample design set forth in its February 29, 2012 submission for each of the Cases. It will prioritize the sample designs for each Case based on the proposed tranching set forth in Plaintiff's Rule 26(f) Report. The specifics of a sample design are dependent on objectives and data available. While the specific features of the *UBS* sample design are appropriate for the *UBS* Action, different sampling designs may be appropriate for other Cases depending on the data produced. Therefore, the specifics of the sample design presented for the *UBS* Action should not be construed as universally applicable. The sample design for the other Cases will vary from the sample design proposed for the *UBS* Action depending on factors such as the number of securitizations at issue in the Case and the distribution of originators across such securitizations. Such factors may influence the appropriateness of clustering, the confidence intervals for each of

the estimates planned from the review, the decision to stratify, and the number and selection of stratification variables.

PROPOSAL

A. The *UBS* Action

The *UBS* Action involves 22 securitizations and 24 unique Supporting Loan Groups.²

Based on the applicable Prospectus Supplements and the loan tapes produced by the *UBS* Defendants, there are a total of 44,426 loans across the *UBS* Supporting Loan Groups and a total of 98,713 loans across the *UBS* securitizations. Defendant *UBS* Securities was the lead underwriter on all 22 securitizations. Fifteen of the 22 securitizations are single-originator securitizations where the loans were originated by one originator. In the remaining seven securitizations, the loans were obtained from multiple originators.³ The chart below summarizes the 15 single-originator deals:

Single-Originator Deals (by Originator)

Argent	Fremont	IndyMac	New Century	Wells Fargo	WMC
• ARSI 2006-W3	• MABS 2005-FRE1 • MABS 2006-FRE2 • FHLT 2006-B	• INABS 2005-C • INABS 2005-D • INABS 2007-A • INABS 2007-A	• MABS 2006-NC2 • MABS 2006-NC3	• MABS 2005-WF1	• MABS 2006-WMC2 • MABS 2006-WMC3 • MABS 2006-WMC4 • MABS 2007-WMC1

B. Plaintiff's Proposed Sample Design For The *UBS* Action

A sample design should identify (i) the purpose of sampling; (ii) the population from which the sample will be selected; (iii) the confidence interval and margin of error; and (iv) if the

² As defined in the complaints in the Cases, Supporting Loan Groups mean the loan group or groups backing the certificates purchased by the GSEs.

³ The seven multi-originator securitizations are MABS 2005-HE2, MARM 2005-8, MARM 2006-2, MARM 2006-OA1, MABS 2007-HE2, MARM 2007-1, and MARM 2007-3.

sample is stratified (as opposed to a simple random sample), the number and selection of the variables used to stratify. Based on the additional information provided by the UBS Defendants, FHFA has supplemented its initial sampling protocol as described in greater detail below.

1. Purpose Of Sampling

FHFA proposes to use sampling to establish the falsity of Defendants' statements regarding (i) the number/percentage of loans that were collateralized by properties that were owner-occupied; (ii) the number/percentage of loans that had LTV ratios above specified values; and (iii) whether the loans were originated in compliance with applicable underwriting guidelines of the originators. *See* Plaintiff FHFA's Proposed Sampling Protocol, dated Feb. 29, 2012, at 5-6. FHFA will select a sample that will enable it to estimate the percentage of loans in the population that contain misrepresentations as to one or more of these three attributes ("Defective Loans").

2. Population Of Mortgage Loans

At the May 14 status conference, this Court specifically inquired whether Plaintiff intended to sample from the Supporting Loan Groups within a particular securitization or across all loans within a particular securitization. *See* Tr. 45:20-23; 47:17-21. The Court further indicated its view that the appropriate population of loans was the Supporting Loan Groups. Plaintiff has proposed from the outset, subject to its right to draw samples of loans from other loan groups, that it would certainly be appropriate to select a sample from the Supporting Loan Groups given that the certificates purchased by the GSEs were collateralized by loans in the Supporting Loan Groups. *See* Plaintiff FHFA's Proposed Sampling Protocol, dated Feb. 29, 2012, at 3 & n.2.

Defendants have refused to limit the population of mortgage loans to the Supporting Loan Groups. Instead, Defendants have agreed only that *at a minimum*, for each case, any

sample must be drawn from the loan pool supporting each certificate in that case. *See* Defendants' Proposed Topics for Meet and Confer Re: Sampling Protocol, at 3 (attached hereto as Exhibit 1) (emphasis added). During a telephonic meet-and-confer on June 5, Defendants further clarified their position and maintained that a sample could not be drawn exclusively from the Supporting Loan Groups. Defendants may very well raise arguments in these Cases that FHFA will need to rebut, which may necessitating sampling from non-Supporting Loan Groups.⁴ Thus, FHFA reserves its right to select a smaller sample of loans from the non-Supporting Loan Groups, if necessary, to rebut any arguments raised by Defendants.⁵

3. Confidence Interval

In its February 29 protocol, FHFA proposed selecting samples that achieve a confidence interval of 95 percent, with a margin of error of plus or minus 5 percent. FHFA identified two available tools to assist in reaching the 95 percent confidence interval: stratification and clustering. FHFA stated in its February 29 submission that: (i) it would examine the characteristics of the loans in a securitization to determine whether and how to stratify the population; and (ii) it would evaluate the possible use of clustering, including considering whether to propose pooling securitizations where the originator or major originators were the same and the loans were originated during the same time period. Having reviewed the data

⁴ Indeed, defendants in an *FHFA* case that has since been transferred made arguments, while that case was pending in this district, that the complaint "plainly places at issue the entire MBS securitizations in which Fannie Mae and Freddie Mac purchased certificates," and that all of the loans in the securitizations are relevant based on allegations regarding artificially inflated ratings of the certificates whose cash flows are cross-collateralized by loans outside the Supporting Loan Groups. *See* Countrywide Defendants' Memorandum of Law in Support of Motion to Stay Pending Centralization with Countrywide Multidistrict Litigation Proceeding, and Opposition to Plaintiffs' Motion to Remand, dated November 1, 2011, at 26-27 (attached as Exhibit 2). Certain Defendants in these Cases joined the Countrywide Defendants' motion to stay and opposition to remand. *See* Joinder of Bank of America Defendants in Countrywide Defendants' Motion to Stay and Opposition to Plaintiff's Motion for Remand; and Joinder of Defendants Citigroup Global Markets, Inc., Deutsche Bank Securities Inc., RBS Securities Inc., and UBS Securities LLC in the Countrywide Defendants' Motion to Stay and Opposition to Plaintiff's Motion to Remand, both dated November 1, 2011 (attached hereto as Exhibits 3 and 4).

⁵ Moreover, in the event that Defendants raise any arguments about the appropriateness of rescission or rescissionary damages, FHFA reserves its right to sample separately in the damages phase, including drawing a smaller sample of loans from non-Supporting Loan Groups.

produced in the *UBS* Action, FHFA has determined (i) to stratify by vintage, originator, and potentially, a third variable depending on additional information received; and (ii) that clustering would not be efficient in the *UBS* Action due to the distribution of originators across the 22 *UBS* Securitizations.⁶

In its February 29 submission, FHFA explained that, to achieve the desired 95 percent confidence interval with a margin of error of plus or minus 5 percent around a point estimate for a population of approximately 4,000 loans or greater, a sample of 384 (rounded up to 400) is sufficient. In order to test and make determinations about the first two representations (owner occupancy and LTV are incorrectly stated), FHFA could select approximately 400 loans from the relevant population (here, all the loans in the *UBS* Supporting Loan Groups). However, in order to make reliable estimates about compliance with underwriting guidelines (which may vary by originator), FHFA has increased its proposed sample size to include (i) a sample of 100 loans from each of the six originators on the 15 single-originator deals; and (ii) an additional 460 loans selected from the group of multiple originators across the seven multi-originator deals, given the absence of detailed originator information on the seven multi-originator securitizations. Thus, based on the information obtained to date, FHFA estimates that the total sample size across all Supporting Loan Groups in the *UBS* Securitizations will be approximately 1,060 loans.

The sample size of 1,060 allows statements to be made about the defect rates regarding Defendants' representations about owner-occupied properties, LTV ratios, and compliance with underwriting guidelines for all *UBS* Securitizations jointly and for each of the six major originators. The larger sample size of 1,060 loans (as compared to the 384 loans) results in a 99 percent confidence level, with a margin of error of plus or minus 4 percent, in making estimates

⁶ The decision not to cluster is based in part on the distribution of originators by vintage.

about the percentage of Defective Loans in the total population. The sample size of approximately 100 loans from each of the six originators in the 15 single-originator deals results in a 95 percent confidence level with a margin of error of plus or minus 10 percent, in making estimates about a specific originator's compliance with underwriting guidelines.⁷

Defendants have indicated that they "believe that, depending on what question(s) the sample is being designed to answer, a 5% margin of error may not be appropriate, and a 2% margin of error may be more appropriate under the circumstances." Ex. 1 at p. 3. However, Defendants were unwilling to share with Plaintiff any information regarding the circumstances under which a 2 percent margin of error would be more appropriate than a 5 percent margin of error. Plaintiff understands that such a reduction in the confidence interval has the potential to increase the sample by a factor of 25. In the *UBS* Action alone, this would increase the sample from 1,060 to over 25,000 loans.

4. Stratification

Based on the information provided in the *UBS* Action, FHFA has identified two stratification variables—vintage and originator. The selection of these two variables was driven in large part by the review of data on the loan tapes produced by UBS, the number of securitizations, and the distribution of single-originator securitizations. After the receipt and review of any additional data, FHFA may decide to include a third stratification variable.

Stratifying by vintage (selecting a proportionate number of loans from 2005, 2006, and 2007 securitizations) enables reliable estimates to be made about the number of Defective Loans over time and enables one to draw conclusions about the rate of such Defective Loans over

⁷ This confidence interval balances the precision of the estimate with the concerns about the size of the sample. It allows one to make reliable estimates about specific originators using a much more reasonable sample size (1,060 loans across the 22 securitizations).

time.⁸ Similarly, stratifying by originator allows reliable estimates to be made about compliance with a specific originator's underwriting guidelines.

In the *UBS* Action, there were seven subgroups (strata) of originators from which to select the sample: (i) the six originators (Argent, Fremont, IndyMac, New Century, Wells Fargo, and WMC) who originated all the loans for the fifteen single-originator securitizations; and (ii) a seventh subgroup of all the originators comprising the multi-originator securitizations. As set forth above in Section 3, 100 loans would be selected from each of the six main originators and an additional 460 loans would be proportionately selected from the seventh subgroup, for a total of 1,060 loans. This approach ensures that the largest originators in those seven deals (which are not the same as the originators in the single-originator securitizations) will be proportionately represented. Additionally, in the *UBS* Action, stratifying by originator has the added benefit of including a representation of the relevant proportions of loans for other variables that may be considered for stratification, including but not limited to, FICO score, LTV/CLTV, documentation type.⁹

Where possible, the number of loans selected from each stratum will be determined in proportion to the size of the population. The distributional information about the total population of loans in each of the strata would be tabulated. Then, based on that information, the proportionate number of loans from that strata would be selected for the sample.

⁸ Although FHFA did not expressly identify vintage as a potential stratification variable in its previous submission, its proposed sampling protocol implicitly included a consideration of the vintage. For example, other methods of sample design, such as selecting samples from each securitization, or clustering securitizations on the basis of common characteristics including vintage, inherently includes a consideration of vintage.

⁹ Although other factors may be used as the stratification variables, there are diminishing returns to adding more strata. As the number of strata increases, the margin of error tends to decrease at a slower and slower rate. Additionally, where some combination of factors is sparse in the population and thus hard to sample, there is no benefit to stratifying. Thus, in keeping the sample size manageable and maintaining a consistent degree of reliability for estimates made about any subgroups, FHFA does not anticipate selecting more than three factors for stratification in the other Cases. These stratification variables may include, among others, LTV/CLTV, documentation program, and FICO score.

5. Extrapolation

Extrapolation from the sample will be relatively straightforward. In order to make estimates about the number of Defective Loans in the Supporting Loan Groups for all *UBS* securitizations combined, FHFA will weight together the results for the individual originators in proportion to their representation in the 22 securitizations. For example, if Argent was responsible for approximately five percent of the total number of loans in the population, the defect rate would be estimated for the population by weighting the Argent defect rate by five percent and the remaining defect rates estimated for other originators by their proportion of the total. In addition, due to the large number of loans selected for each of the originators, reliable statements about the estimated defect rates can be made for each of the six originators on the 15 single-originator securitizations. Provided the information on the loan tapes is complete, FHFA will also be able to relate the defects in the loans to characteristics such as FICO scores, debt-to-income ratios, LTV/CLTV ratios, occupancy status, and other data from the loan origination process.

CONCLUSION

For the reasons set forth above and in FHFA's February 29, 2012 pleading, FHFA respectfully requests that this Court approve FHFA's proposed sampling protocol.

Dated: June 6, 2012
New York, New York

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